

THE PROSPECTS OF BELARUS JOINING IN THE EXPLOITATION OF ODESSA – BRODY PIPELINE

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SUMMARY

Odessa – Brody oil transportation project is given much prominence from the perspective of the EU energy safety. The route is viewed as a core element of the programme to diversify oil delivery to Europe and give Caspian oil access to European markets bypassing Russia. Although the construction of Odessa – Brody pipeline was finalised in 2003 and the European Investment Bank promised to subsidise its extension to Płock ‘on special terms’ (<http://www.oilcapital.ru/info/projects/63395/private/71862.shtml>), the pipeline is still working on the reverse basis, the prospects of its direct use being rather vague. If Belarus participated in the project alongside Central European oil transiting countries, it could strengthen the project and contribute to the EU energy safety.

The research examines the prospects of Belarus joining in Odessa – Brody project. For this purpose, we analyse the way the Belarusian oil transportation complex functions and the place it takes in the country’s energy safety and economic security, as well as the role it plays in oil delivery to the EU. We also study the steps the government is planning to take in the field of oil transportation. The conclusion summarises the factors that can both nudge the Belarusian government towards joining in Odessa – Brody project and motivate it to decide on alternative ways of maintaining the country’s role in oil transit via its territory.

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1. INTRODUCTION

At present, Russia is an exclusive supplier of crude oil for the Belarusian oil industry, which makes up to 40 per cent of the country's exports. Russia used to offer the Belarusian oil industry such huge preferences in oil trade as compared to the other countries of the region, that diversifying oil delivery to Belarus did not look financially viable.

However, since the terms of oil trade with Russia changed in 2007, considering that Russia is going to have equalised the energy prices for the whole region by 2011, Belarus has shown interest in alternative sources of oil supply. According to the Complex Programme to Modernise the Belarusian Energy Industry's Basic Production Assets by 2011, approved of by the President in November 2007 (<http://pravo.by/webnpa/text.asp?start=1&RN=P30700575>) by 2010 20 per cent of the total annual oil supply to Belarus could be provided from alternative sources. At the same time, the fact that the favourable terms of supplying Russian oil to Belarus are bound to be sustained up to the end of 2009 essentially discourages the Belarusian government from seeking alternative sources. Besides, there is also a chance that the preferences could be extended further into the future. For this reason, the Belarusian government has to be careful in its negotiations on alternative routes of oil transportation to Belarus.

The research assesses the viability and studies the prospects of Belarus joining in Odessa – Brody project. Part 2 analyses the way the country's petrochemical industry is functioning in terms of maintaining stable and economically viable oil supply. It also looks into the changes the petrochemical industry might undergo if Russia chooses to use alternative oil transit routes. Part 3 focuses on measures to make the Belarusian oil industry profitable in connection with the expected alterations in the oil transportation routes in the region. Part 4 examines the factors that influence decision-making on the existing oil transportation options and affect the chances of Belarus joining in Odessa – Brody project. The conclusion contains recommendations on energy policies from the perspective of strengthening the region's energy safety.

2. THE PLACE AND STRUCTURE OF OIL INDUSTRY IN THE NATIONAL ECONOMY

Oil refining, exporting petrochemicals and oil transit make the foundation of the Belarusian national economy, since a number of key economic indicators such as GDP growth, etc. to a great extent depend on oil industry.

However, up to the late 1990s oil industry played a much less important role in the country's economy. But from 1999 onwards, the Belarusian government has taken action to stimulate petrochemical exports and oil transit. Thus, the profits from exporting petrochemicals have allowed for the partial compensation for the increased cost of purchasing oil. In 2004 for the first time in the country's history the oil export revenues exceeded the cost of purchasing oil (i.e. the revenues from selling oil on the domestic market became the oil industry's net profit). As a result, the share of oil and petrochemicals in the country's exports has considerably grown. For example, it made only 8 per cent of the total exports in 2000, 18 per cent in 2002, 25.4 per cent in 2004 and 40 per cent in 2007 (source: the Ministry for Statistics and Analysis, <http://belstat.gov.by>).

The Belarusian oil transportation industry has its market share of about 30 per cent in the transit of Russian oil to the EU. Of 197.345 m tons of oil that Russia exported to the EU in 2007, 72 m tons were transported via Belarus.

2.1. SUPPLY, TRANSIT AND REFINING

The Belarusian oil industry consists of oil transporting facilities and refineries.

Oil is supplied to Belarus via the Druzhba pipelines, which make an integral part of the Russian (Soviet) pipeline network beginning at the Russian oil fields near Surgut. The Druzhba oil main network, some parts of which run through Belarus, is the core transit route for Russian oil exports. The Druzhba Central Despatch Service is located in the vicinity of Unecha town, Russia.

All Belarusian oil facilities come under the state-owned umbrella concern called Belneftekhim.

It includes:

- Homieltransneft Druzhba national unitary enterprise, which operates the Druzhba southern line. Oil is transported in two directions: Unecha – Homiel – Mazyr – Kobryń – Adamowo (Poland) and Unecha – Homiel – Mazyr – Brody (Ukraine). In addition, the enterprise is in charge of tuning, putting into operation, diagnosing, exploiting and maintaining all basic and subsidiary equipment, technical facilities and control units for the oil mains. It also deals in buying, storing and selling crude oil and petrochemicals (<http://www.transoil.by/about>).
- Druzhba oil transporting national unitary enterprise in Navapołack, which operates the Druzhba eastern branch: Unecha – Połack – Vientspils (in Połack it forks off towards Mažeikiai). It also deals in buying, storing and selling crude oil and petrochemicals.
- Belorusneft national unitary enterprise, which produces oil and sells it both on the domestic and international markets.
- Naftan oil refinery in Navapołack, a joint stock venture, which produces a wide range of petrochemicals, buys crude oil and sells petrochemicals.
- Mazyr Oil Refinery, a joint stock venture, which produces a wide range of petrochemicals, buys crude oil and sells petrochemicals.

Belarus buys and sells Russian oil exclusively. Oil purchasing and transportation are regulated by the following Belarus – Russia agreements:

- Belarus – Russia Agreement of 13 November 1992;
- The Agreement between the Governments of the Russian Federation and the Republic of Belarus on the Energy Industries' Co-operation and Development of 15 September 1994 with annual protocols;
- The Agreement on the Customs Union of the Russian Federation and the Republic of Belarus of 6 January 1995;
- The Protocol on Introducing Free Trade without any Exceptions or Limitations between the Russian Federation and the Republic of Belarus of 6 January, 1995;
- The Agreement on Price Policies of 27 February 1996;
- The Russian Federation's Energy Industry's Profit and Loss Account with annual protocols signed by the Russian and Belarusian Governments from 1997 onwards;
- The Agreement between the Russian and Belarusian Governments on Regulating Commercial Co-operation in Oil and Petrochemical Exports of 12 January 2007.

Balanced tariff policies, efficient export duty manipulations, co-operation with Russian oil companies, political loyalty and the favourable geographical position allowed Belarus to have augmented its oil transit and refining. The share of Belarusian routes in Russia's total oil exports increased from 28 per cent in 1999 to 45 per cent in 2004. Russian oil supplies to the Belarusian refineries grew from 10 m tons in 1998 to 18.5 m tons in 2004.

Table 1. The Belarusian Oil Industry Performance, 2001–2007 (m tons)

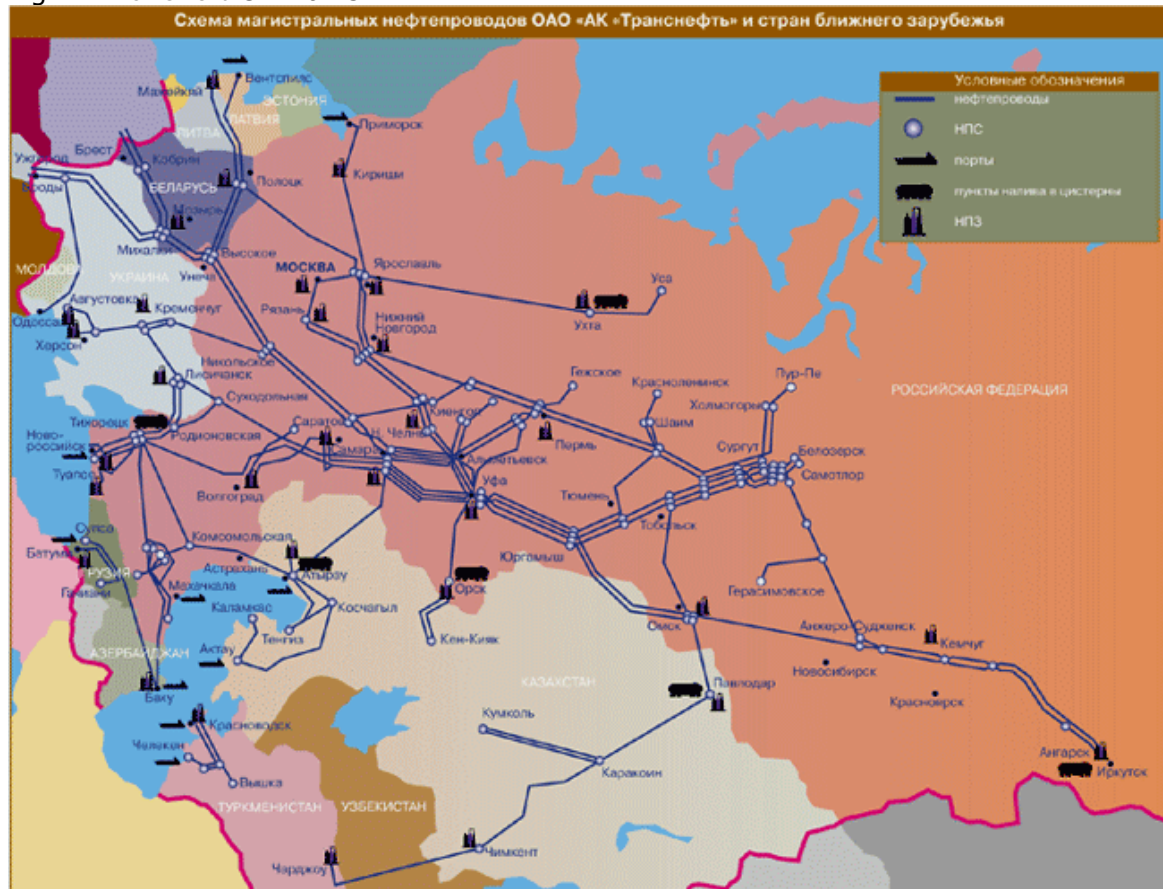
	2001	2002	2003	2004	2005	2006	2007
Transportation	98.9	93.45	100.7	103.7	106.18	98.282	89.27
Transit, of which:	85.1	74.2	84.2	84.2	87.7	78.7	72
Druzhba, Homiel	70.9	70.1	72	71.3	72.9	70.9	72
Druzhba, Navapolack	14.2	4.1	12.2	12.9	14.8	7.9	0
Supplies from Russia	11.9	13.9	14.7	17.7	19.2	20.9	20.0
Refining, of which:	13.27	15.2	15.6	18.533	19.714	21.542	21.363
Mazyr	6.021	7.5	7.5	9.399	9.476	10.763	10.671
Naftan	7.249	7.7	8.1	8.585	8.649	10.779	10.692
Extracting		1.84	1.78	1.77	1.76	1.78	1.76
Petrochemical exports	7.7	9.9	10.6	13.0	13.5	14.8	15.1

Sources: Prime-TASS. <http://www.prime-tass.by>, the Ministry for Statistics and Analysis, <http://belstat.gov.by>, personal archives.

Belarus has always commanded a bit lower tariffs than the other oil transiting countries: \$0.73 per ton towards Ukraine, \$0.41 per ton towards the western border, \$0.6 per ton to Butinge terminal in Mažeikiai and \$0.71 towards Latvia. The tariffs were agreed upon with the Russian Ministry for Energy in 1995. Enabling Belarus to win the competition for transit with Ukraine, the tariff policies provided for the increase in oil transportation via the territory of Belarus in 1996–2005. Meanwhile, Ukraine saw the opposite tendency: oil transportation via Ukraine kept falling, from 92 m tons in 1991 to 46.7 m tons in 2005. The Druzhba pipeline forks off in Mazyr, Belarus, where Mazyr refinery is located. Its Ukrainian line goes across the north of Ukraine, whereas the Belarusian one crosses the south of Belarus. It is quite easy to redirect oil flows from one branch to the other, and Homieltransneft Druzhba, operating the southern Belarusian line, grew and further developed at the expense of its Ukrainian counterpart.

Fig. 1 shows how the pipelines are interconnected.

Fig. 1. Transneft Oil Mains



Source: Transneft Joint Stock Company, <http://www.transneft.ru/Schema/Schema.asp?LANG=RU>.

Owing to the tariff advantage, it was the southern Homieltransneft Druzhba that kept steadily increasing its transit. In 1996 it transported 24 m tons towards Poland and Germany and reached the peak of 73.9 m tons in 2005. Navapołack Druzhba maintained its transit at the same level till 2002. When the first division of the Baltic pipeline network (BPN) was launched in December 2001, it led to a dramatic fall in transit via Navapołack Druzhba, which ceased to transport oil towards Vientspils. In 2002 Navapołack Druzhba was able to bring back its transit very closely to the earlier levels by increasing its transit towards Mažeikiej. However, since 2006 oil transportation via this line has once again fallen drastically due to a serious accident in July 2006 at the Russian section of Unecha – Połack Druzhba pipeline (perfect timing: just by then the BPN total capacity had reached 60 m tons of oil annually). As Table 1 shows, this has resulted in ceasing oil transit since mid 2006. The pipelines are now being filled only with oil supplied to Navapołack refinery. Consequently, the total transit of Russian oil via Belarus has dwindled. In addition, since 2007 oil transit from Mazyr to Adamowo (i.e. towards Poland and Germany) has been declining. In 2007 46.223 m tons of oil was transported towards Adamowo, which was 6.6 per cent less as compared to 2006. The loss was partially offset when the Ukrainian pipeline Odessa – Brody was launched in co-operation with the Russian TNK-BP in 2006 in the reverse mode. In 2007 oil transit from Mazyr to Brody (Ukraine) made 25.814 m tons, which was 20.8 per cent more than in 2006.

The launch of BPN-1 struck a heavy blow to the Belarusian oil transporting industry. From 1 December 2006 onwards, Belarus had to increase the tariff for oil transportation towards Mazyr refinery from \$0.45 to \$0.75 per ton (see the Resolution of the Ministry for Economy No. 194 of 4 December 2006). Since February 2007 route tariffs for oil transit via Belarus have gone up (see the Resolution of the Ministry for Economy No. 26 of 31 January 2007). (The route tariffs are calculated for the whole transportation distance, whereas specific ones account for the transportation of a ton of oil for 100 km.) The oil transit tariff makes \$3.5 per ton along Unecha – Adamowo route and \$1.5 per ton from Unecha to Brody. The rise in the route tariffs means that the specific tariffs have grown from \$0.41 to \$0.6 per ton. On 4 January 2008 the Ministry for Economy issued its Resolution No. 6, which increased the tariffs for transporting oil to the Belarusian refineries: €1.3 to Naftan in Navapołack and to €0.29 for Belarusian companies and €0.6 for Russian companies to Mazyr refinery. At the same time, Belarus did not consider it financially viable to increase its oil transportation tariffs following a similar decision by Russia, enacted from 1 September 2008.

2.2. OIL TRANSIT AND SUPPLY PROBLEMS

Belarus's tariff policies in the transportation of Russian oil to Europe create an incentive for Russian companies to give preference to the Belarusian transit routes and Belarusian refineries. In its turn, the share of the Belarusian routes in Russia's transit is a good reason for keeping the subsidised prices of oil supply to Belarus. However, throughout 2007 Transneft focused on undermining the Belarusian routes. The Russian oil exporting monopolist's CEOs successfully lobbied the Russian government to adopt an investment plan for expanding the facilities in Primorsk and constructing BPN-2. Besides, Transneft was able to prove that it was not feasible to restore Navapołack line of the Druzhba, which had stopped functioning following the accident at Unecha – Połack section. Rostekhnadzor had checked up the Druzhba pipelines, to reveal that over 95 per cent of Unecha – Połack section with a capacity of about 15 m tons of oil annually did not meet the safety requirements. According to Transneft's conclusion, dealing with Rostekhnadzor's criticisms and meeting its standards would actually mean constructing a new pipeline, which is pointless, considering the plans for the construction of BPN-2. The project aims at laying a 1,138 km long pipeline from Unecha to Primorsk. The Belarusian lines of the Druzhba begin at Unecha, too. The trans-shipment point's capacity is 100 m tons of oil annually, of which 20 m tons is transported to Belarus to be refined and 70 m tons is transited abroad. If Unecha – Primorsk branch is constructed, the transit via Belarus is bound to be reduced, depending on its capacity.

The launch of BPN-1 has caused degradation of the northern Belarusian branch of the Druzhba pipeline. Similarly, the construction of BPN-2 threatens to put the brakes on the use of the southern branch. A drop in transit and transit revenues (in 2007 the transit receipts made \$196.2 m, of which \$52.1 was the national budget revenues) is bound to affect the oil transportation industry's investment potential. This would entail degradation of the pumping stations and pipelines, just as the case was in Ukraine. Its oil transit industry once had a capacity of about 100 m tons annually, but now has to limit its expectations to 65 m tons in 2010, by the most optimistic estimates, and 70 m tons in 2015, provided Odessa – Brody project starts functioning in the direct mode and the Druzhba pipelines are integrated with Adria.

In addition, a fall in Russian oil transit via Belarus is likely to damage the country's position in its negotiations with Moscow on the terms of oil supply and put at risk the prospects of Russian oil being refined for export by the Belarusian refineries. As a result, the country's oil industry could dwindle to supplying the domestic market only, which makes less than 10 m tons annually, as compared to the today's 21 m tons.

Being well aware of the challenges, the Belarusian government is concerned with seeking new options to maintain oil transit and refining at their present levels.

3. POSSIBLE SOLUTIONS

In the field of oil supply and transit, the Complex Programme to Modernise the Belarusian Energy Industry's Basic Production Assets (<http://pravo.by/webnpa/text.asp?start=1&RN=P30700575>) considers two possible alternatives to the existing scheme: in the southern direction via Odessa and northwards via the Baltic ports of Ventspils, Butinge and Klaipeda.

The northward route requires arranging for reverse oil traffic along the pipeline from Ventspils port. It would mean changing 6 km of pipes, building an oil pumping station and stock-taking facilities, altering the technological pattern of Giukste and Skrudaliena way stations and constructing a reservoir park for 100–150 thousand m³. The required investment is estimated at \$40 m.

The southward route presupposes the following:

- provided the combined route is used (along Odessa – Brody oil mains, with further trans-shipment into tank-cars in Brody and transportation by rail), there is no need for any investment;
- supposing the Russian oil transit dwindles and the existing oil mains are used, it would require constructing a 205 km long connection Boboviči – Kaściukovičy. The necessary investment is estimated at approximately \$120 m, according to the 2004 feasibility report, which needs updating;
- supposing the existing Russian oil transit remains the same, it would require constructing a 800 km long pipeline section and three oil pumping stations and rebuilding the station in Kaściukovičy. This would require about \$530 m, according to the 2004 feasibility report, which needs updating.

The Programme does not express preference to any of the above-mentioned routes.

The government has also developed the Programme of Effective Use of Belarus's Transit Facilities for 2006 – 2010 (<http://pravo.by/webnpa/text.asp?start=1&RN=C20500700>) and passed Resolution No.743, which makes some amendments to the Programme (<http://pravo.by/webnpa/text.asp?start=1&RN=C20700743>). According to the Programme, providing Ukraine takes a decision to exploit Odessa – Brody pipeline in the direct mode and there are potential investors interested in the project, Belarus could also contribute to it.

Note

Ukraine finalised the construction of 674 km long Odessa – Brody pipeline in 2002. Its rated capacity is 14 m tons of oil annually. Initially the project was meant to transport Caspian oil towards Ukraine's western border for European buyers. However, the pipeline did not operate till 2004, as Ukraine had failed to find oil suppliers. In mid 2004, Ukrtransneft Co. and TNK-BP signed a 3-year agreement on the reverse use of the pipeline. It provides for transporting 9 m tons of oil annually towards Yuzhny sea oil terminal near Odessa, a Black Sea port. At present Odessa – Brody pipeline is operated on the reverse basis by TNK-BP. In 2007 it accounted for the transportation of 9.1 m tons of oil.

3.1. SELLING THE PIPELINES

Yet both the programmes also consider bringing back to life the northern line of the Druzhba, which goes towards Ventspils and Mažeikiej. Relaunching Navapoľack line does not require laying new pipelines on the Belarusian territory. It does not presuppose any large-scale investment, and Belarus can restore the existing infrastructure on its own. What is needed in order to relaunch the

northern pipeline is that Russia should take interest in the project. Thus, on 3 September Belneftekhim Deputy Chairperson Uładzimir Voŭkaŭ said that Belarus had offered a share of the Druzhba oil transporting enterprise in Navapołack and Homieltransneft Druzhba to Transneft, the Russian oil transporting monopolist. Both enterprises have been entered into the Plan to Privatise State-owned Enterprises and are to become joint stock companies in 2008. 'There is a possibility of co-operating with Transneft,' said Uładzimir Voŭkaŭ. 'Choosing it as a partner would be quite logical. Both the enterprises are state-owned unitary ones, both are going to be privatised. So we could be considering our co-operation with the strategic investor.'

Russia has not yet given any answer to the proposal. Moreover, it is unlikely to reply until BPN-2 has become irreversible. As we have already said, the Russian BPN is apparently in direct competition with the Druzhba pipelines. A lot of subcontractors, such as builders, pipe suppliers, pipe producers, rolled metal producers, etc. have already got engaged in the BPN project. The core of its lobbyists' argument is that the Belarusian route appears to be unsafe and unreliable. It was the Belarus – Russia energy conflict in the early 2007, followed by ceasing the transit along the Belarusian section that became the main reason for the approbation of BPN-2 project by the Russian government. However, if Russia has its share in the management of the Belarusian oil transporting enterprises, the Belarusian route is likely to become more reliable. Even the negotiations only on the possibility of Transneft taking over the Belarusian oil transporting enterprises might be enough for the Russian government to block BPN-2 project. For this reason, it is highly improbable that Transneft should put at risk its top priority project until the Russian government has taken its final decision on it and at least one third of the construction has been completed. Strategic importance of BPN-2 for Transneft lies in sustaining its dominant position in supplying Eurasian oil to Europe rather than guaranteeing stable and reliable transit. Owning a share in the Belarusian oil transporting enterprises is in line with this goal. So is the prospect of future relaunching of Navapołack line. These steps would result in excess capacities for oil transportation to the EU. The Baltic states would turn into the BPN supporters, which would drastically reduce the chances of alternative oil transportation projects, including Odessa – Brody.

3.2. ALTERNATIVE OIL TRANSPORTATION ROUTES: JOINING IN ODESSA – BRODY PROJECT AND THE LITHUANIAN PROPOSAL

If Russia came to own a share in the Belarusian oil transporting enterprises, it would guarantee maintaining or even increasing its transit via Belarus. However, should Russia show no interest in it (or, for that matter, show it too late) Belarus will be interested in arranging for oil transportation via alternative routes, in order to compensate for the losses. At present there are two alternative projects being considered, which appear to be complementary rather than mutually exclusive.

The first one is about the reverse use of Navapołack line, which is to be filled with oil in the Baltic ports. 'By our estimates, it would not require any considerable technical alterations,' commented Belneftekhim Deputy Chairperson Uładzimir Voŭkaŭ on 3 September. 'All the necessary work can be done in Butinge port, so that it can increase its oil input capacity to be able to supply crude oil both to Mažeikiu Nafta and to Navapołack refinery, if the project proves financially viable.' Mr Voŭkaŭ said that at present Mažeikiu Nafta refinery is supplied with oil delivered in tankers from Primorsk via Butinge terminal. Oil is to be supplied further on along the pipelines functioning in the reverse mode. 'For this option to be carried out, things should turn out in such a way that will make the project evidently feasible,' said Mr Voŭkaŭ.

The second alternative is Odessa – Brody project. Belarus could join in it under the following conditions:

- a. Ukraine should take a decision on its direct use;
- b. The Caspian countries should guarantee that it is supplied with enough oil to function on a steady and stable basis;
- c. The project should prove financially viable.

a. So far the decision on the direct use of Odessa – Brody pipeline has not been taken. Since President Juščenko signed his Decree on Providing for Odessa – Brody Pipeline Functioning in the Direct Mode on 22 May 2008, the future of the pipeline seems to be a tool in the fight for political dominance between President Juščenko and Prime Minister Timošenko. Russia is opposed to the project and Ukraine depends on Russia for energy supplies. So the Ukrainian government will hardly take its final decision on the project until Russia has equalised the terms of its energy deliveries for all of the region, including Ukraine or unless Ukraine stands hardly any chance of getting Russian energy supplies at subsidised prices.

b. The prospects of Odessa – Brody being filled with Caspian oil are just as vague. For Belarus to be motivated to join in, the pipeline should function in the direct mode, with a guarantee that it is filled to full capacity, i.e. 14 m tons annually. This would require both Baku and Astana joining in. However, the Kazakh leader, who has always been rather circumspect concerning the project, is bound to become twice as cautious following Russia's operation in the Caucasus. Besides, Kazakhstan doubts if it will be able to supply the required amounts of oil. 'In making plans, I would advise considering the actual oil yield rather than the prognoses for 2015. They could turn out nothing more than prognoses. Another problem of oil production is the high concentration of sulphur in it. Neither Kazakhstan nor Ukraine possesses a technology to extract sulphur compounds keeping the oil price competitive,' said Islambek Arystanbekov, a representative of the Kazakh Embassy to Ukraine.

The special Ukrainian interagency group to provide for the direct use of the pipeline informs that by 14 July 2008 contracts to supply 8.25 m tons of Caspian oil annually to two Ukrainian refineries (Haličyna refinery and Naftochimik Prikarpattia) and to the Ukrainian border with Hungary and Slovakia had been drafted on the 'pump and pay' basis. This is enough to partially provide for Ukraine's needs (the two refineries have the combined rated capacity of 5.5 m tons annually, but in fact no more than 2 m tons are now being refined) and possibly get Hungary and Slovakia interested in buying Azerbaijani oil. But this is not enough to make the idea of building an extension towards Gdańsk and connections to the Belarusian – Polish border feasible.

Yet, things with the 8.25 m tons of Azerbaijani oil that was confirmed on July 14 are not at all clear. According to *Economicheskije Izvestia* (<http://economica.com.ua/oil/article/115646.html>), although Ilkham Aliev has declared more than once that Azerbaijan's intentions are quite serious, Ukraine 'has not yet prepared any definite proposals on the terms of co-operation, which should be approved by all the government departments and companies involved and should not cause controversies between the President's Secretariat and the government.'

Moreover, according to John Roberts, Platts Co. expert on energy security, the Georgian war could pose a serious problem to any project aimed at Caspian oil transportation

(http://news.bbc.co.uk/hi/russian/business/newsid_7558000/7558832.stm). Mr Roberts predicts that Russia is likely to increase its pressure on the Caspian oil producers in order to make them use Russian transportation routes. At the same time western companies will be faced with a much bigger challenge when it comes to seeking investment in any major project in the Southern Caucasus. The reason is that Baku – Supsa pipeline destination point is only 25 km from Poti, the Georgian port recently bombed by Russia, via which most of the Georgian imports are transported. To make things still worse, the Azerbaijani terminal of Kulevi, where Azerbaijani and Kazakh oil transported from Baku by rail is trans-

shipped into tankers, is situated between Baku and Supsa. Such dangerous proximity to the possible war theatre considerably undermines the safety estimations of any projects to increase Caspian oil supplies.

c. Whether it is economically feasible for Belarus to join in Odessa – Brody project is going to depend on the pricing relationship between Azerbaijani and Russian oil on the Belarusian border, the difference between the price of Russian crude oil and petrochemicals to be sold at the overseas markets and the same difference for Azerbaijani oil, the amounts of Russian oil companies' transit via Belarus, the Belarusian refineries' facilities to refine low-sulphur oil, and major investors interested in the construction of a connection along the Belarusian territory.

At present due to the special Belarus – Russia contracting relations Russian oil is much cheaper for Belarus than Azerbaijani oil.

In January – July 2008 Belarus bought Russian oil at \$532 per ton, or \$72.4 per barrel. Meanwhile, the average price of petrochemicals for export made \$744 per ton.

At the same time Russian oil URALS cost \$109.1 per barrel, or \$802 per ton on the international market.

According to the Belarus – Russia Supplementary Agreement of 30 January 2007, from 2007 onwards the oil prices for Belarus are to be calculated as follows: world oil price on the Belarusian – Polish border + a duty (29 per cent of the export duty for 'overseas countries') - the cost of oil transportation across Belarus. The formula allowed Belarus to buy Russian oil some 26–30 per cent cheaper than neighbouring countries.

It is not clear on what conditions Azerbaijan is going to deliver its oil to transiting countries, but Azerbaijani oil is anyway more expensive than Russian oil.

For example, on 1–5 September the average price of AZERI LT (CIF) oil sold by Azerbaijan via the Turkish port of Ceyhan and the Georgian port of Batumi made \$107.7 per barrel, whereas the price of URALS oil in the same region was \$102.73 per barrel. Azerbaijani oil appears to be even more expensive than BRENT, which on 1 – 5 September cost \$104.7 per barrel in the Black Sea region.

It is the high quality of Azerbaijani oil that allows Azerbaijan to command higher prices. AZERI has a density of 36 degrees API and contains 0.14 per cent of sulphur, whereas URALS has a density of 32 degrees API and contains 1.3 per cent of sulphur (BRENT Dated has a density of 38.3 degrees API and contains 0.36 per cent of sulphur)

(<http://capital.trendaz.com/index.shtml?show=news&newsid=1288850&lang=RU>). Thus, the price makes the feasibility of Belarus joining in Odessa – Brody project rather doubtful. The reason is that transit revenues only, without accounting for the needs of the country's petrochemical industry, cannot be a strong enough incentive for Belarus to participate in the project.

The high quality of Azerbaijani oil is also an obstacle. In recent years the Belarusian refineries have spent vast sums of money on buying and installing equipment to refine heavy Russian oil. There will be no need for deep rectification equipment, should the Belarusian refineries be supplied with light Azerbaijani oil. The Polish PKN Orlen can serve as a good example: its experts justify its dependence on Russian oil on the grounds that the facilities for rectifying heavy crude oil have to be kept operating.

By the way, Elshad Nasirov, the Azerbaijani State Oil Company's Vice-President for Investment and Marketing, has recently doubted whether the Ukrainian refineries will be able to rectify AZERI LIGHT.

4. THE PROSPECTS AND FACTORS OF DECISION-MAKING

On 22 August Ukrainian Ambassador to Belarus Ihor Lichovoj reminded that Belarus had been given a signal to join in the project. 'This year Kiev hosted a major energy forum and summit. The Belarusian Ministers for Energy and

Economy were present there,' said the diplomat and added that Belarus should take its own well-informed decision.

What is meant here is joining in the Sarmatia International Pipeline Company. At present the Azerbaijani State Oil Corporation (ASOC), the Georgian Oil and Gas Corporation (GOCR), the Ukrainian Ukrtransnafta, the Polish Przedsiębiorstwo Eksploatacji Rurociągów Naftowych Przyjazn S.A. own 24.75 per cent of its shares each, with 1 per cent belonging to the Lithuanian AB Klaipėdos Nafta. It is expected that a feasibility report on Odessa – Brody – Płock – Gdańsk pipeline will have been prepared by December. The project will offer a way of transporting oil from the Caspian to the Baltic region.

At present Belarus is not conducting any negotiations on joining in the project. In May Belneftekhim Deputy Chairperson Michał Asipienka said that the parties involved were discussing the prospects of constructing a pipeline to transport Caspian oil to Gdańsk. 'We are not engaged in it,' said Mr Asipienka. 'If Belarus receives a proposition to join in, we will submit our proposals to the Belarusian government. This refers in particular to the construction of Bobroviči – Kaściukovičy connection. We have some designs, but first thing we must have a guarantee that extra oil is to be pumped via the pipeline. Such a guarantee is missing so far.'

However, Belarus could become much more interested in participating, should there be a fall in oil transportation via the southern Belarusian line of the Druzhba. In this case, the extension of Odessa – Brody pipeline to the southern Belarusian line would secure the functioning of the southern route. At present Belarus is taking action to provide for the steady operation of the southern Belarusian line by Russian companies. Towards this end, both oil transporting enterprises are to be turned into joint stock companies in 2008. It is supposed that their shares will be sold to Russian Transneft. The reasons why it will be interested in undermining the Belarusian route for at least two years are given above. By then Belarus and Russia will have to sign a new agreement on oil supplies to Belarus, as the one of 12 January 2007 will have expired. It is the terms of delivery and transit of Russian oil to Belarus that are to become the core factor in taking a decision on whether to join in the Odessa – Brody project and, which is more, whether Belarus should participate in any oil supply and transit plans alternative to Russian ones.

Considering that Russia has already come up with an informal offer to the Czech Republic concerning 'direct' oil supplies (<http://www.nr2.ru/economy/195116.html>), it would be logical to expect that Russia is going to prolong its 'special relations' with Belarus. After all, the country controls the Druzhba pipeline section which appears to be a direct competitor of Odessa – Brody pipeline. The Russian elite sees no alternative to their country's development other than as an 'energy superpower', which makes them spare no effort in order to put the brakes on any alternative plans to supply the EU with oil.

In our opinion, the only thing that gives the Ukrainian pipeline a chance is the timing. The two competing projects – the construction of BPN-2 and sustaining the transportation via the Belarusian section of the Druzhba pipeline – cannot be carried out simultaneously. So at each stage one of the projects will be given priority over the competing one. The Belarusian government is going to make a decision on joining in alternative oil supplying projects depending on the state of the market in 2010. It is the time when new terms of oil supply to Belarus are going to be discussed, a major part of BPN-2 will supposedly have been constructed and Poland will have taken a final decision on participating in Odessa – Brody project.

4. CONCLUSIONS

For the time being economic viability of Belarus joining in Odessa – Brody project seems rather doubtful. However, Belarus is dependent for oil on its only supplier, Russia, which is apt to take revenge on its unyielding partners when it comes to the terms of oil supply and transit. That was the case with Belarus in January 2007 and with the Czech Republic in 2008. (By the way, Vladimir Putin agreed that disruptions were caused by the absence of direct contracts between the Russian suppliers and the Czech consumers, as well as Ukraine's intention to start oil transportation in the direct mode along Odessa – Brody pipeline: <http://www.rbc.ru/rbsfreenews/20080721144415.shtml>). These facts could nudge the Belarusian government towards making a more thorough cost-and-benefit analysis, which would include the high risks caused by dependence on the only supplier.

To prepare a more detailed feasibility study of Belarus's participation in Odessa – Brody project, it is necessary:

- to re-calculate the cost of constructing a pipeline section from Brody to the southern line of the Belarusian Druzhba;
- to estimate how likely European companies and financial institutions are to participate in the construction;
- to estimate the price of Caspian oil, including the costs of its delivery to Belarus via Odessa – Brody pipeline and by sea to Odessa;
- to estimate how likely it is that the Russian companies will deploy the construction of BPN-2 alongside sustaining oil transit via the Druzhba, considering the forecasts for oil production in Russia and its transportation towards Europe;
- to estimate to what degree Mazyr refinery could be interested in refining Caspian oil;
- to negotiate with the Sarmatia International Pipeline Company's shareholders.